STATE OF TENNESSEE
OFFICE OF THE
ATTORNEY GENERAL
SECOND FLOOR CORDELL HULL BUILDING
425 FIFTH AVENUE NORTH
NASHVILLE, TENNESSEE 37243-0488

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Opinion No. 99-119

Power of Tennessee Regulatory Authority to Regulate Issuance of Debt by Public Utilities Engaged in Interstate Commerce

QUESTIONS

1. Is the opinion of the Attorney General attached hereto, dated September 2, 1939, regarding the predecessor statute to Tenn. Code Ann. §§ 65-4-103 and 65-4-109, still valid?

2. If the answer to number one above is in the affirmative, please explain the authority and jurisdiction of the Tennessee Regulatory Authority under Tenn. Code Ann. § 65-4-109 in the following scenarios:

Scenario 1:
A natural gas utility with facilities in Tennessee, that is part (e.g., a subsidiary or division) of a company with multistate operations that is seeking the issuance of debt for the sole purpose of supporting its Tennessee operations.

Scenario 1(a):
A natural gas utility with facilities in Tennessee, that is part of a company with multistate operations that is seeking the issuance of debt for the benefit of the entire operation, including those located within Tennessee.

Scenario 2:
An electric light/power utility that is part of a company with multistate operations that is seeking the issuance of debt for the sole purpose of supporting its Tennessee operations.

Scenario 2(a):
An electric light/power utility with facilities in Tennessee, that is part of a company with multistate operations that is seeking the issuance of debt for the benefit of the entire operation, including those located within Tennessee.

Scenario 3:
A water utility that is part of a company with multistate operations that is seeking the issuance of debt for the sole purpose of supporting its Tennessee operations.

Scenario 3(a):
A water utility with facilities in Tennessee , that is part of a company with multistate operations that is seeking the issuance of debt for the benefit of the entire operation, including those located within Tennessee.

Scenario 4:
A telecommunications service provider as defined in Tenn. Code Ann. § 65-4-101(c) that is part of a company with multistate operations that is seeking the issuance of debt for the sole purpose of supporting its Tennessee operations.

Scenario 4(a):
A telecommunications service provider as defined in Tenn. Code Ann. § 65-4-101(c) with facilities in Tennessee, that is part of a company with multistate operations that is seeking the issuance of debt for the benefit of the entire operation, including those [facilities] located within Tennessee.

Scenario 5:
A competing telecommunications service provider as defined in Tenn. Code Ann. § 65-4-101(e) that may or may not have facilities in Tennessee, but is part of a company with multistate operations that is seeking the issuance of debt for the sole purpose of supporting its Tennessee operations.

Scenario 5(a):
A competing telecommunications service provider as defined in Tenn. Code Ann. § 65-4-101(e) that may or may not have facilities in Tennessee, but is part of a company with multistate operations that is seeking the issuance of debt for the benefit of the entire operations, including those located within Tennessee.

3. If the answer to number one above is in the negative, what is the extent of the Tennessee Regulatory Authority's jurisdiction to approve the issuance of indebtedness by a public utility engaged in interstate commerce?

4. Does the Tennessee Regulatory Authority have the ability to approve an issuance of debt that has already been issued?

OPINIONS

1. Yes, while there remains the possibility of further developments in the law in this area, it is the opinion of this office that the opinion dated September 2, 1939, as regards a proposed securities issuance by an interstate telephone service provider, remains valid.

2. Under Scenarios 1 and 1(a), state regulation is preempted by the federal Natural Gas Act as construed in *Schneidewind v. ANR Pipeline Company,* 485 U.S. 293 (1988).

Under Scenarios 2 and 2(a), state regulation may or may not be preempted depending on the construction given certain provisions of the Federal Power Act.

Scenarios 3 and 3(a) deal specifically with water utilities. It does not appear that water utilities are generally subject to federal regulation, although the issuance of securities by a water utility would presumably be subject to the jurisdiction of the federal Securities and Exchange Commission. Nevertheless, under the Commerce Clause state authority to regulate securities issuances by interstate water utilities may be proscribed under certain facts, especially if the facts are such that the application of state regulation could create a cumulative burden for the utility based on its having similar operations in many states.

Scenarios 4, 4(a), 5, and 5(a) deal with telecommunications providers. Telecommunications providers are certainly subject to federal regulation. Decisions from other state courts have found state regulation precluded under the Commerce Clause. Depending on the specific facts presented, state regulation could likely be proscribed, especially if the facts are such that the application of state regulation may create a cumulative burden for the utility based on its having similar operations in many states.

3. This question is not reached.

4. Assuming facts to which Tenn. Code Ann. § 65-4-109 is properly applicable, the statute requires that the Tennessee Regulatory Authority provide its prior approval of any securities issuance. At the discretion of the authority, a penalty of fifty dollars per day of violation can be imposed under Tenn. Code Ann. § 65-4-120. Nevertheless, even if prior approval is not obtained, the Authority may, if it deems appropriate, exercise its discretion not to penalize or take other enforcement action against the issuing utility.

ANALYSIS

Tennessee Statutes

The Tennessee statutory provisions regarding the regulation of debt issuances by public utilities are codified at Tenn. Code Ann. §§ 65-4-103 and 65-4-109. Tenn. Code Ann. § 65-4-109

provides as follows:

> No public utility shall issue any stocks, stock certificates, bonds, debentures, or other evidences of indebtedness payable in more than one (1) year from the date thereof, until it shall have first obtained authority from the authority for such proposed issue. It shall be the duty of the authority after hearing to approve any such proposed issue maturing more than one (1) year from the date thereof upon being satisfied that the proposed issue, sale and delivery is to be made in accordance with law and the purpose of such be approved by the authority.

Tenn. Code Ann. § 65-4-103 provides as follows:

> The provisions of this chapter shall be construed to apply to and affect only public utilities which furnish products or services within the state, and this chapter shall not be construed to extend to any public utility engaged in interstate commerce the government or regulation of which jurisdiction is vested in the interstate commerce commission or other federal board or commission.

These provisions were enacted into law by Chapter 49 of the Public Acts of 1919, and have remained essentially unchanged, except that enforcement of the provisions is now charged to the Tennessee Regulatory Authority.

Under the cited code sections the Tennessee Regulatory Authority has the duty of approving any proposed issuance of securities by a public utility furnishing products or services in Tennessee, provided that the jurisdiction of the Tennessee Regulatory Authority does not extend to "any public utility engaged in interstate commerce the government or regulation of which jurisdiction is vested in the interstate commerce commission or other federal board or commission." As construed in *Tennessee Public Service Commission v. Nashville Gas Company,* 551 S.W.2d 315 (1977), *cert. denied,* 434 U.S. 904 (1977), *petition for rehearing denied,* 434 U.S. 988 (1977), Tenn. Code Ann. § 65-4-103 does not altogether prevent the regulation by Tennessee of public utilities engaged in interstate commerce and subject to federal regulation, if it is clear that federal law does not prohibit such state regulation.

The 1939 Attorney General Opinion

In 1939 this Office opined as to the jurisdiction of the Railroad and Public Utilities Commission of Tennessee over the issuance of debentures by the Southern Bell Telephone & Telegraph Company. Southern Bell was engaged in interstate commerce and was subject to regulation by the Federal Communications Commission. Southern Bell was operating in nine states,

including Tennessee. The opinion held that the debt issuance transaction would affect Southern Bell's indivisible interstate operations and was therefore an interstate transaction which could not be regulated in Tennessee. The opinion relies on the case of *City of Memphis v. Enloe*, 141 Tenn. 618, 214 S.W. 71 (1919), in which the Court had noted in passing that the Railroad and Public Utilities Commission had no jurisdiction to apply its regulatory powers to the issuance of debt by an interstate railroad, since a "railroad is an entirety and all of its bonds, stocks or other evidences of indebtedness cover the entire road."

Federal Preemption

The Commerce Clause of the United States Constitution, art. I, § 8, cl. 3 provides that the Congress shall have the power to regulate commerce among the states. In addition, the Supremacy Clause, art. VI, cl. 2, provides that the "Constitution and laws of the United States which shall be made in Pursuance thereof . . . shall be the supreme Law of the Land." A state law which conflicts with federal law requirements is preempted or "without effect." *Riggs v. Burson*, 941 S.W.2d 44 (Tenn. 1997), *citing Maryland v. Louisiana*, 451 U.S. 725, 746, 101 S.Ct. 2114, 2128, 68 L.Ed.2d 576 (1981). Federal statutory preemption may be explicit or implied. Preemption may be inferred where the pervasiveness of the federal regulation precludes supplementation by the States, where the federal interest in the field is sufficiently dominant, or where "the object sought to be obtained by the federal law and the character of obligations imposed by it . . . reveal the same purpose." *Rice v. Santa Fe Elevator Corp.*, 331 U.S. 218, 230, 67 S.Ct. 1146, 1152, 91 L.Ed. 1447 (1947). Where Congress has not entirely displaced state regulation in a particular field, state law is still pre-empted when it actually conflicts with federal law. Such a conflict will be found " 'when it is impossible to comply with both state and federal law, *Florida Lime & Avocado Growers, Inc. v. Paul*, 373 U.S. 132, 142-43 [83 S.Ct. 1210, 1217-18, 10 L.Ed.2d 248] (1963), or where the state law stands as an obstacle to the accomplishment of the full purposes and objectives of Congress, *Hines v. Davidowitz*, 312 U.S. 52, 67 [61 S.Ct. 399, 404, 85 L.Ed. 581] (1941).' " *California Coastal Commission v. Granite Rock Co.*, 480 U.S. 572, 581, 107 S.Ct. 1419, 1425, 94 L.Ed.2d 577 (1987), *quoting Silkwood v. Kerr-McGee Corp.*, 464 U.S. 238, 248, 104 S.Ct. 615, 621, 78 L.Ed.2d 443 (1984). Even in the absence of congressional legislation, the dormant or negative component of the Commerce Clause limits a state's power to impose burdens upon interstate commerce. *Lewis v. B.T. Investment Managers, Inc.*, 447 U.S. 27, 35, 100 S.Ct. 2009, 2015, 64 L.Ed.2d 702 (1980); *Hughes v. Oklahoma*, 441 U.S. 322, 326, 99 S.Ct. 1727, 1731, 60 L.Ed.2d 250 (1979).

In determining whether a state regulation unconstitutionally burdens interstate commerce, the courts apply a balancing test which weighs the legitimacy of the local interest and the local benefits of regulation against the burden imposed on interstate commerce:

> Where [a] statute regulates evenhandedly to effectuate a legitimate local public interest, and its effects on interstate commerce are only incidental, it will be upheld unless the burden imposed on such commerce is clearly excessive in relation to the putative local

> benefits. . . . If a legitimate local purpose is found, then the question becomes one of degree. And the extent of the burden that will be tolerated will, of course, depend on the nature of the local interest involved, and on whether it could be promoted as well with a lesser impact on interstate activities.

Pike v. Bruce Church, Inc., 397 U.S. 137, 142, 90 S.Ct. 844, 847, 25 L.Ed.2d 174 (1970).

Case law

In the case of *Rice v. Santa Fe Elevator Corp.*, 331 U.S. 218, 230, 67 S.Ct. 1146, 1152, 91 L.Ed. 1447 (1947), the Supreme Court considered the effect of the federal Warehouse Act on state regulation of grain warehousemen engaged in interstate commerce. On matters directly regulated by the Act, the Court found that the federal enactment precluded state regulation, even if such state regulation did not necessarily conflict with federal law. The Court also considered whether the federal act precluded a state regulation requiring approval by the state for the issuance of long-term securities by warehousemen. Because the federal Act did not expressly address the issuance of securities, the Court found that Congress had not "foreclosed state action." The state regulation was allowed to stand without further analysis. Nevertheless, subsequent cases decided at the state level tended to strike down state attempts to regulate the issuance of securities by interstate utilities. In *United Air Lines v. Nebraska State Railway Commission*, 112 N.W.2d 414 (Nebr. 1961), the Nebraska Supreme Court held that the Nebraska Commission could not constitutionally require its prior approval for an issuance of debentures by United Air Lines. The Court emphasized the interstate nature of United Air Lines' operation and the fact that only a small portion of the business was conducted within the state of Nebraska. Based on the specific facts of the case, the Court held that the application of the statute in this instance constituted an unconstitutional burden on interstate commerce. Subsequently, in *United Air Lines v. Illinois Commerce Commission*, 207 N.E.2d 433 (Ill. 1965), the Illinois Supreme Court also had occasion to consider the constitutionality of an Illinois statute requiring state approval of securities issuances by public utilities regulated in Illinois. There was no claim of federal preemption. Relying solely on the Commerce Clause, the Court held that the state regulation as applied to United Air Lines was unconstitutional. In an oft-quoted passage, the Court summed up its reasoning as follows:

> If Illinois can exercise the power to approve or disapprove the issuance of United's securities because it transacts business here, then so also can each of the other sixteen States where United provides intrastate service. There would thus be a total of seventeen jurisdictions asserting the power to approve or reject any issuance of stock proposed by United. The task of seeking and gaining approval from such a number of States would be unjustifiably expensive, time consuming and burdensome, and could create delay which would directly impair the usefulness of United's facilities for interstate

> traffic. Just as important, each independent regulating authority would be required to apply locally defined standards of public interest and locally defined rules in order to approve or disapprove . . . a single issuance of securities. The result, we believe, would be chaotic.

Subsequent state decisions tended to follow closely the reasoning expressed in the *United Air Lines v. Illinois* decision. State attempts to exercise regulatory jurisdiction over the issuance of debt by interstate utilities were struck down in *North Carolina v. Southern Bell Telephone and Telegraph Company*, 217 S.E.2d 543 (N.C. 1975) (issuance of stock and bonds by an interstate telecommunications carrier); *Panhandle Eastern Pipe Line Company v. Public Utilities Commission,* 383 N.E.2d 1163 (Ohio 1978) (issuance of securities by an interstate natural gas pipeline company); *Western Union Telegraph Company v. Public Service Commission*, 338 N.W.2d 731 (Mich. Ct. App. 1983) (issuance of securities by an interstate telecommunications carrier); and *Michigan Bell Communications, Inc. v. Michigan Public Service Commission*, 399 N.W.2d 49 (Mich. Ct. App. 1986) (issuance of securities by an interstate telecommunications carrier).

On the other hand, in 1979 the Michigan Supreme Court issued a pair of decisions upholding Michigan regulatory jurisdiction over the issuance of debt by a natural gas utility and an electric power utility, respectively. *Michigan Gas Storage Company v. Michigan Public Service* Commission, 275 N.W.2d 457 (Mich. 1979) and *Indiana and Michigan Power Company v. Michigan*, 275 N.W. 2d 450 (Mich. 1979). Both decisions considered the effect of applicable federal regulations and found that state regulation was not precluded by either federal statutory enactment or the Commerce Clause. Neither decision was appealed, but the holding of *Michigan Gas Storage* was subsequently overruled by the United States Supreme Court in *Schneidewind v. ANR Pipeline Company,* 485 U.S. 293 (1988), in which the Court held that the federal Natural Gas Act impliedly precluded state regulation of the securities issuances of interstate natural gas utilities because both statutory schemes were ultimately aimed at the same purpose of controlling the rates and facilities of natural gas providers. Because the Court specifically relied on statutory preclusion, the effect of the Commerce Clause alone was not reached.

Two common themes clearly emerge from the opinions in the above-cited cases. First, as a factual matter courts have observed that the financing of an interstate business necessarily affects the operation of the entire business and the transaction cannot be allocated among the various states in which the business operates. In *United Air Lines v. Illinois Commerce Commission*, 207 N.E.2d 433 (Ill. 1965) the Court stated that "[t]he issuance of securities is a single, indivisible act. It cannot be fractionalized and given portions allocated to specific States." *Id* at 437. In *North Carolina v. Southern Bell Telephone and Telegraph Company*, 207 S.E.2d 771 (N.C. 1975), the Court noted that "[t]he issuance of a security by Southern Bell is a single, indivisible act. While the proceeds may be invested in one state or another as Southern Bell's management may from time to time decide, the issuance of the security cannot be so allocated." *Id.* at 721. In *Western Union Telegraph Company v. Public Service Commission*, 338 N.W. 2d 731 (Mich. Ct. App. 1983), the Court stated

that "[a] securities issue is a single, indivisible act which cannot be allocated among the different states." *Id.* at 732. This case law would suggest that even a debt issuance which is for "the sole purpose of supporting . . . Tennessee operations" cannot be allocated strictly to Tennessee since the debt issuance itself would affect the entire interstate business.

Second, courts have expressed concern over the potential chaos and disruption that would ensue if every state in which an interstate utility operated could require that the utility obtain the prior approval of the state before issuing securities.

The Scenarios

Therefore, the scenarios presented can be considered as follows: Based on the holding of *Schneidewind,* state regulation under proposed scenario 1(a), the issuance of debt by a multistate natural gas utility with facilities in Tennessee for the benefit of the entire operation, is pre-empted by the Natural Gas Act. Proposed scenario 1 varies in that under 1 the proposed issuance is "for the sole purpose of supporting its Tennessee operations." It is difficult to know precisely what facts are anticipated under this scenario. The best case might be to assume that the issuance is intended to finance the construction of facilities located only in Tennessee which will be used for the sole purpose of serving Tennessee customers. Even under these assumed facts, however, the issuance would very likely be considered part of interstate commerce since it would undoubtedly have an effect on the company as a whole and would also impact the market for natural gas, which is ultimately interstate in nature and not limited by the boundaries of Tennessee. As Supreme Court noted in *Arkansas Electric Coop. v. Arkansas Public Service Commission*, 461 U.S. 375, 103 S.Ct. 1905, 76 L.Ed.2d 1 (1983), "the production and transmission of energy is an activity particularly likely to affect more than one State, and its effect on interstate commerce is often significant enough that uncontrolled regulation by the States can patently interfere with broader national interests." *Id.* at 377, 103 S.Ct. at 1908-09. Thus it appears that the same result obtains under Scenario 1 as Scenario 1(a) and state regulation is preempted by the federal Natural Gas Act.

Scenarios 2 and 2(a) are the same as scenarios 1 and 1(a) except that they involve an electric power company rather than a natural gas company. Electric power utilities are regulated by the Federal Energy Regulatory Commission (FERC) pursuant to the Federal Power Act (FPA). Unlike the NGA, the FPA has specific provisions dealing with the issuance of securities by utilities. 16 U.S.C. § 824c requires electric utilities to obtain authorization from the FERC prior to the issuance of securities, except that the statute also provides that its provisions are not to extend to a "public utility organized and operating in a State under the laws of which its security issues are regulated by a state commission." Further, 16 U.S.C. § 825q provides that the FPA does not apply to the extent a person otherwise subject to the FPA is subject to the Public Utility Holding Company Act of 1935 (PUHCA). Under the PUHCA, the issuance of securities is subject to the approval of the Securities and Exchange Commission (SEC), although the SEC is authorized under some circumstances to exempt persons from the PUHCA, in which case the provisions of the FPA would be applicable. In the case of *Indiana and Michigan Power Company v. Michigan*, the Michigan Supreme Court

considered the validity of a Michigan statute requiring that Michigan electric utilities obtain approval from the Michigan Public Service Commission before issuing securities. The plaintiff was a registered public utility holding company under the PUHCA and was therefore subject to the jurisdiction of the SEC regarding its securities issuances. The plaintiff argued that federal provisions of the PUHCA and regulation by the SEC pre-empted state regulation. The Michigan Supreme Court held that the provisions of the PUHCA were not intended to preempt state regulation of the issuance of securities. The Court went on to hold that state regulation of the securities issuance also did not violate the Commerce Clause. The *Indiana and Michigan Power Company* case was not appealed to the Supreme Court. While there is some basis for the Court's finding that federal law was not intended to occupy the field of electric utility securities regulation, the result is far from clear. For example, in a companion case, *Michigan Gas Storage v. Public Service Commission*, 275 N.W.2d 457 (Mich. 1975), the same Court arrived at a similar conclusion regarding natural gas utilities and the NGA. That holding was eventually overruled by the United States Supreme Court in *Schneidewind.* For interstate electric utilities not subject to the PUHCA, but rather subject to the FPA, the effect of the FPA exclusion from jurisdiction for a "public utility organized and operating in a State under the laws of which its security issues are regulated by a state commission" is not clear. While this statement would tend to demonstrate an intention not to preempt state regulation, it is not clear that it should be construed as an affirmative grant of authority under the Commerce Clause. Therefore, even in the absence of preemption, the question would remain as to whether state regulation is prohibited by the Commerce Clause. *Indiana and Michigan Power Company* has not been followed by similar decisions in other jurisdictions. In addition, the case could be limited to its facts since the interstate activities of the utility in question were extremely slight. All the company's assets, operations, and sales were located in Michigan.

Scenarios 3 and 3(a) deal specifically with water utilities. It does not appear that water utilities are generally subject to federal regulation, although the issuance of securities by a water utility would presumably be subject to the jurisdiction of the federal Securities and Exchange Commission. Nevertheless, under the Commerce Clause state authority to regulate securities issuances by interstate water utilities may be proscribed under certain facts, especially if the facts are such that the application of state regulation may create a cumulative burden for the utility based on its having similar operations in many states.

Scenarios 4, 4(a), 5, and 5(a) deal with telecommunications providers. Telecommunications providers are certainly subject to federal regulation. Decisions from other state courts in the cases of *North Carolina v. Southern Bell Telephone and Telegraph Co.*, 207 S.E.2d 771 (N.C. 1975); *Western Union Telegraph Co. v. Public Service Commission*, 338 N.W. 2d 731 (Mich. Ct. App. 1983); and *Michigan Bell Communications, Inc. v. Michigan Public Service Commission*, 399 N.W.2d 49 (Mich. Ct. App. 1986) (issuance of securities by an interstate telecommunications carrier), have found state regulation precluded under the Commerce Clause. Depending on the specific facts presented, state regulation appears to be proscribed, especially if the facts are such that

the application of state regulation may create a cumulative burden for the utility based on its having similar operations in many states.

PAUL G. SUMMERS
Attorney General and Reporter

MICHAEL E. MOORE
Solicitor General

STEVEN D. THOMAS
Assistant Attorney General

Requested by:

The Honorable K. David Waddell
Executive Secretary
Tennessee Regulatory Authority
460 James Robertson Parkway
Nashville, Tennessee 37243-0505